

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

TERRY L. RITTER,) Case No. 08-3074 SC
)
Plaintiff,) ORDER GRANTING IN
) PART AND DENYING IN
v.) PART DEFENDANTS'
) MOTION TO DISMISS
)
STEVEN PETER SMALL; LAW OFFICES OF)
STEVEN P. SMALL; ROBERT VON FELDEN;)
ECO-FIBER SOLUTIONS, INC., a)
California Corporation; NVS GROUP-)
DISPLAY INNOVATIONS, INC., a)
Delaware Corporation, also known as)
NVS GROUP-DISPLAY PACKAGING)
INNOVATIONS; AND DOES 1 THROUGH)
100,)
)
Defendants.)

I. INTRODUCTION

This matter comes before the Court on the Motion to Dismiss ("Motion") by the defendants Steven Peter Small ("Small"), the Law Offices of Steven P. Small ("Law Offices"), Robert Von Felden ("Von Felden"), Eco-Fiber Solutions, Inc. ("Eco-Fiber"), NVS Group-Display Innovations, Inc. ("NVS") (collectively, "Defendants"). Docket No. 11. The plaintiff Terry L. Ritter ("Plaintiff" or "Ritter") filed an Opposition and the Defendants submitted a Reply. Docket Nos. 24, 25. For the following reasons, Defendants' Motion is GRANTED in part and DENIED in part.

1 **II. BACKGROUND**

2 The present action arises out of the alleged efforts by
3 Defendants Small and Von Felden to induce Plaintiff to agree to
4 pay \$5,000,000 over 12 months to purchase 45% of the stock in the
5 company Eco-Fiber. Compl. ¶ 11. Plaintiff allegedly paid a total
6 of \$400,000 of the \$5,000,000 to Defendants before filing this
7 lawsuit. Id. ¶ 18e. The alleged misrepresentations began
8 February 20, 2008. Id. ¶ 13.

9 Eco-Fiber was incorporated in August of 2007 and uses the law
10 office of Defendant Small for its offices. Id. ¶ 4. Von Felden
11 is listed as the President of Eco-Fiber. Compl. Ex. A, Memorandum
12 of Understanding ("MOU"). According to Plaintiff's allegations,
13 Von Felden and Small misrepresented to Plaintiff that Von Felden
14 had assigned to Eco-Fiber proprietary and patentable chemical
15 treatments for water-resistant, non-wicking paper for use in
16 multiple markets, including food, frozen food, fresh fish, etc.
17 Compl. ¶ 18a. In addition, Plaintiff alleges that, although
18 Defendants Small and Von Felden told Plaintiff that the money he
19 invested in the company would be used for bona fide post-
20 investment costs, including the marketing of Eco-Fiber to major
21 industry companies, Plaintiff's capital was actually used to pay
22 personal expense items of Defendants, including Defendant Small's
23 daughter's cell phone bill. Id. ¶ 18b.

24 Based on these and other allegations, Plaintiff filed suit in
25 this Court under the following causes of action: (1) securities
26 fraud under section 10b of the Securities and Exchange Act of 1934
27 ("Securities Act"); (2) the offer and sale of unregistered
28

1 securities in violation of section 12(a)(1) of the Securities Act;
2 (3) the sale of securities in violation of the California
3 qualification requirement of California Corporations Code Sections
4 25110 and 25130; (4) material representation in securities
5 transaction under California corporate securities law, California
6 Corporations Code Section 25501; (5) common law fraud; (6)
7 negligent misrepresentation; (7) conversion of Plaintiff's money;
8 (8) injunctive relief; and (9) declaratory relief.

9
10 **III. LEGAL STANDARDS**

11 **A. Motion to Dismiss**

12 A Federal Rule of Civil Procedure 12(b)(6) motion to dismiss
13 tests the sufficiency of the complaint. Dismissal pursuant to
14 Rule 12(b)(6) is appropriate if the plaintiff is unable to
15 articulate "enough facts to state a claim to relief that is
16 plausible on its face." Bell Atl. Corp. v. Twombly, 127 S. Ct.
17 1955, 1974 (2007). "[F]aced with a Rule 12(b)(6) motion to
18 dismiss a § 10(b) action, courts must, as with any motion to
19 dismiss for failure to plead a claim on which relief can be
20 granted, accept all factual allegations in the complaint as true."
21 Tellabs, Inc. v. Makor Issues & Rights, LTD., 127 S. Ct. 2499,
22 2509 (2007). All reasonable inferences are to be drawn in favor
23 of the plaintiff. Everest & Jennings, Inc. v. Am. Motorists Ins.
24 Co., 23 F.3d 226, 228 (9th Cir. 1994). Unreasonable inferences or
25 conclusory legal allegations cast in the form of factual
26 allegations, however, are insufficient to defeat a motion to
27 dismiss. W. Mining Council v. Watt, 643 F.2d 618, 624 (9th Cir.

1 1981).

2 **B. Private Securities Litigation Reform Act ("PSLRA")**

3 Section 10(b) of the Securities Exchange
4 Act of 1934 forbids the "use . . . in
5 connection with the purchase or sale of
6 any security . . . , [of] any manipulative
7 or deceptive device or . . . in
8 contravention of such rules and
9 regulations as [SEC] may prescribe as
10 necessary or appropriate in the public
11 interest or for the protection of
12 investors."

13 Tellabs, 127 S. Ct. at 2507 (citing 15 U.S.C. § 78j(b))
14 (alterations and brackets in original).

15 Securities and Exchange Commission ("SEC") Rule 10b-5,
16 promulgated under the authority of section 10(b), in turn,
17 provides:

18 It shall be unlawful for any person . . .
19 (a) To employ any device, scheme, or
20 artifice to defraud, (b) To make any
21 untrue statement of a material fact or to
22 omit to state a material fact necessary
23 in order to make the statements made, in
24 light of the circumstances under which
25 they were made, not misleading, or (c) To
26 engage in any act, practice, or course of
27 business which operates or would operate
28 as a fraud or deceit upon any person, in
connection with the purchase or sale of
any security.

17 C.F.R. § 240.10b-5.

22 The enactment of the PSLRA in 1995 significantly altered
23 pleading requirements in private securities fraud litigation by
24 requiring that a complaint plead with particularity both falsity
25 and scienter. In re Daou Systems, Inc., 411 F.3d 1006, 1014 (9th
26 Cir. 2005). Thus, under the PSLRA, a complaint alleging that the
27 defendant made a false or misleading statement must "specify each

1 statement alleged to have been misleading [and] the reason or
2 reasons why the statement is misleading." 15 U.S.C. § 78u-
3 4(b)(1). In addition, the complaint must "state with
4 particularity facts giving rise to a strong inference that the
5 defendant acted with the required state of mind." Id. § 78u-
6 4(b)(2). In the Ninth Circuit this state-of-mind requirement
7 demands that "the complaint . . . allege that the defendants made
8 false or misleading statements either intentionally or with
9 deliberate recklessness." Daou Sys., 411 F.3d at 1015.

10 In addition to the heightened PSLRA pleading standards, "[i]t
11 is well established that claims brought under Rule 10b-5 and
12 section 10(b) must meet the particularity requirements of Federal
13 Rule of Civil Procedure 9(b)." Id. at 1014. Rule 9(b) states
14 "[i]n alleging fraud or mistake, a party must state with
15 particularity the circumstances constituting fraud or mistake."
16 Fed. R. Civ. P. 9(b).

17 The basic elements of a Rule 10b-5 claim include the
18 following: (1) a material misrepresentation or omission of fact,
19 (2) scienter, (3) a connection with the purchase or sale of a
20 security, (4) transaction and loss causation, and (5) economic
21 loss. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005).

22 23 **IV. DISCUSSION**

24 When ruling on a 12(b)(6) motion to dismiss a § 10(b) action,
25 courts must consider the complaint in its entirety, including
26 "documents incorporated into the complaint by reference, and
27 matters of which a court may take judicial notice." Tellabs, 127
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1 S. Ct. at 2509. In the present case, Plaintiff attached to his
2 Complaint an MOU signed by himself and Defendant Von Felden on
3 February 21, 2008. Compl. Ex. A.

4 Defendants' primary argument in favor of dismissal is that
5 Plaintiff has failed to meet the heightened pleading requirements
6 of the PSLRA. Defendants assert that "Plaintiff has only made
7 general, broad-brush allegations that are unspecific and thus
8 vague in that he has not identified the time and place of each
9 alleged misrepresentation or omission nor has he identified the
10 allegedly responsible person in either set of allegations." Mot.
11 at 7. This argument, however, ignores many of Plaintiff's
12 allegations. For example, Plaintiff's Complaint contains the
13 following allegations:

14 On February 20, 2008, at Scott's Seafood
15 Restaurant in Walnut Creek, in the
16 presence of [P]laintiff, Shamim Ritter,
17 and Marc Vogel, Von Felden was asked by
18 [P]laintiff how the \$5,000,000 cash
contribution would be scheduled. Von
Felden stated that it would be on an as-
needed basis and \$250,000 would take
[Eco-Fiber] 'through the end of June.'

19 Compl. ¶ 13. Plaintiff further alleges that this \$250,000 was not
20 nearly enough to fund Eco-Fiber through June of 2008 and that
21 Small and Von Felden demanded, and received, \$400,000 from
22 Plaintiff by May of 2008, some of which was used to pay themselves
23 higher salaries. Id. ¶¶ 18e, 18i.

24 Plaintiff's Complaint also states:

25 [O]n February 21, 2008, [P]laintiff,
26 Shamim Ritter, Marc Vogel, Small, and Von
27 Felden met at Small's law offices, and
after discussion of the terms and
conditions, plaintiff and Von Felden

1 executed a 'binding' MOU for
2 [P]laintiff's investment, and [P]laintiff
3 handed Von Felden a check for \$100,000.

4 Id. ¶ 16. This MOU, according to Plaintiff, "was highly
5 misleading [and] failed to adequately describe risk factors . . .
6 ." Id. ¶ 18f.

7 Plaintiff further alleges the following:

8 On February 21, 2008, when [P]laintiff
9 inquired of [Eco-Fiber's] needs, Small
10 stated to [P]laintiff that [Eco-Fiber]
11 need[s] \$200,000 to \$250,000 to get the
12 company through June 2008, at which time
13 the Tyson Foods order 'would be kicking
14 in.'

15 Id. ¶ 17. This Tyson Foods order, however, was, according to
16 Plaintiff's allegations, entirely speculative. Id. ¶ 18d.

17 These factual allegations are more than sufficient to meet
18 the pleading requirements of the PSLRA and of Federal Rule of
19 Civil Procedure 9(b).

20 Defendants also assert that Plaintiff's factual allegations
21 regarding the alleged violation are insufficient, as a matter of
22 law, to establish scienter and falsity. "As set out in §
23 21D(b)(2) of the PSLRA, plaintiffs must 'state with particularity
24 facts giving rise to a strong inference that the defendant acted
25 with the required state of mind.'" Tellabs, 127 S. Ct. at 2504
26 (citing 15 U.S.C. § 78u-4(b)(2)). In the Ninth Circuit, "the
27 required state of mind is one of deliberate or conscious
28 recklessness." No. 84 Employer-Teamster Joint Council Pension
Trust Fund v. Am. W. Holding Corp., 320 F.3d 920, 931 (9th Cir.
2003). The Court in Tellabs defined a "strong inference" as the
following:

[T]o determine whether a complaint's scienter allegations can survive a threshold inspection for sufficiency, a court . . . must engage in a comparative evaluation: it must consider, not only inferences urged by the plaintiff . . . , but also competing inferences rationally drawn from the facts alleged. . . . To qualify as "strong" within the intendment of § 21D(b)(2), we hold, an inference of scienter must be more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.

Id. at 2504-05. Thus, a "complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." Id. at 2510.

As discussed above, the Court is satisfied that Plaintiff's Complaint presents the sufficiently particularized allegations of fact required for a Rule 10b-5 claim. In short, Plaintiff has alleged that Defendants knew that the overall health and development of Eco-Fiber was not nearly as strong as they, in an effort to secure further funding, represented to him. Accepting these factual allegations as true, Plaintiff has sufficiently pleaded violations of the Securities Exchange Act.

Under Tellabs, a court must look not only to the inference urged by the plaintiff but also to any other inferences a reasonable person could draw from the factual allegations. See Tellabs, 127 S. Ct. at 2510 (stating that a "complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged"). Defendants

1 urge the Court to find some unnamed, undescribed, "equally
2 compelling innocent inferences that may be drawn from the facts .
3 . ." Mot. at 10. At this stage, the Court finds none.

4 Defendants also argue that because section 10(b) prohibits
5 misrepresentations "in connection with the purchase or sale of any
6 security," 15 U.S.C. § 78j, Plaintiff, in failing to allege an
7 actual sale of securities, has failed to plead a section 10(b)
8 violation. Defendants assert that because the MOU did not provide
9 for the immediate issuance of stock, there was no sale nor
10 purchase of stock, and therefore 15 U.S.C. § 78j is inapplicable.
11 This argument, however, ignores the MOU, which states "Equity
12 Ownership: 45% of Company Stock." Compl. Ex A. At the very
13 least, this language appears to give Plaintiff the option to buy
14 45% of Eco-Fiber's stock and, as the United States Supreme Court
15 has held, the term "security" under Rule 10b-5 covers not only the
16 actual stock but also "the option to purchase that stock." Wharf
17 (Holdings) Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588, 593
18 (2001). Defendants' argument is therefore without merit.

19 Defendants next argue that Plaintiff's claims against the Law
20 Offices and against NVS should be dismissed because Plaintiff
21 failed to allege "reliance upon any statement or omission or
22 action" by the Law Offices or NVS. Mot. at 11. In Stoneridge
23 Investment Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct.
24 761 (2008), the Supreme Court held that the implied right of
25 action under section 10(b) of the PSLRA "does not extend to aiders
26 and abettors." Id. at 769. Rather, "[t]he conduct of a secondary
27 actor must satisfy each of the elements or preconditions for
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1 liability." Id.

2 Regarding NVS, a company controlled by Von Felden, Plaintiff
3 has alleged that NVS submitted a false purchase order to Eco-Fiber
4 in the amount of \$52,000. Compl. ¶ 23. This purchase order was
5 allegedly used by Defendants to inflate the amount of orders Eco-
6 Fiber actually had and to induce Plaintiff to invest more money.
7 Id. As Plaintiff has alleged that NVS "engaged in a deceptive act
8 within the reach of the § 10(b) private right of action," NVS is a
9 properly named Defendant. Stoneridge Inv. Partners, 128 S. Ct. at
10 769.

11 The connection between Plaintiff's allegations and the Law
12 Offices is less clear. Perhaps recognizing this, Plaintiff
13 concedes that he cannot "maintain a separate judgment against Law
14 Office of Steven P. Small if it has no legal identity apart from
15 Defendant Small." Opp'n at 15. Plaintiff appears to also argue
16 that the Law Offices were sued in the capacity of Steven Small
17 doing business as the Law Offices of Steven P. Small. Opp'n at
18 15. Defendant Small seems to confirm this, as the Defendants'
19 Motion states: "Steven Peter Small ("Small"), as an individual and
20 erroneously sued as the Law Offices of Steven P. Small"
21 Mot. at i.

22 Explaining the use of "doing business as," the California
23 Court of Appeal has stated: "The designation of 'DBA' or 'doing
24 business as' simply indicates [the defendant] operates under a
25 fictitious business name." Pinkerton's, Inc. v. Super. Ct., 49
26 Cal. App. 4th 1342, 1348 (Ct. App. 1996). "Use of a fictitious
27 business name does not create a separate legal entity." Id. As
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1 explained by another federal district court, "[d]oing business
2 under another name does not create an entity distinct from the
3 person operating the business." Duval v. Midwest Auto City, Inc.,
4 425 F. Supp. 1381, 1387 (D. Neb. 1977). "The individual who does
5 business as a sole proprietor under one or several names remains
6 one person, personally liable for all his obligations." Id.; see
7 also Tr. of the Mason Tenders, Dist. Council Welfare Fund, Pension
8 Fund, Annuity Fund & Training Program Fund v. Faulkner, 484 F.
9 Supp. 2d 254, 258 (S.D.N.Y. 2007) (stating "[t]he designation
10 'd/b/a' means 'doing business as' but is merely descriptive of the
11 person or corporation who does business under some other name.
12 Doing business under another name does not create an entity
13 distinct from the person operating the business.") (internal
14 quotation marks and alterations omitted).

15 Even if Plaintiff had named the Law Offices in the capacity
16 as "doing business as," which Plaintiff failed to do, the Court
17 can discern no reason why the Law Offices would need to be named
18 if the individual Defendant Small is already named as a defendant.

19 More importantly, perhaps, Plaintiff has failed to allege any
20 behavior by the Law Offices that would satisfy the pleading
21 requirements under the PSLRA. Plaintiff merely alleges that many
22 of the meetings between Plaintiff and Defendants Small and Von
23 Felden occurred at the Law Offices. See, e.g., Compl. ¶¶ 16, 18,
24 23. Plaintiff has failed to allege that the conduct of the Law
25 Offices satisfied any of the "elements or preconditions for [§
26 10(b)] liability." Stoneridge Inv. Partners, 128 S. Ct. 769. For
27 all of these reasons, the Court DISMISSES Defendant Law Offices of
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1 Steven P. Small without prejudice. Plaintiff may amend the
2 Complaint within 30 days.

3 Defendants' remaining arguments in favor of dismissal are
4 either without merit or require further factual development and
5 are therefore premature.

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7 **V. CONCLUSION**

8 For the reasons stated above, Defendants' Motion to Dismiss
9 with respect to Defendant the Law Offices of Steve P. Small is
10 GRANTED without prejudice. Plaintiff may amend within 30 days
11 from the date of this Order. Defendants' Motion is otherwise
12 DENIED.¹

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15 IT IS SO ORDERED.

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17 Dated: October 31, 2008



18 UNITED STATES DISTRICT JUDGE
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26 _____
27 ¹ Plaintiff's seek a finding by the Court that the present
28 Motion constitutes a Rule 11 violation. The Court declines to make
such a finding.